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northwest economic
# indicators

NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS AN AFFILIATE OF NORTHWEST BANCORPORATION

# Economy In The Eighties

April 17, 1980

## Highlights

- **The degree of uncertainty in the economy is unprecedented. Under the circumstances, conservatism, caution and risk management should be the byword of the day.**
- **Three key mistakes — excessive government spending, over-regulation and excessive reliance on foreign oil — must be corrected before the nation begins to turn around the dismal economic trend.**
- **A strong national leadership, which can rally the citizens to bite the bullet, will be crucial to make things happen. Therefore, the upcoming national election will significantly influence the economic and social well-being of the 1980s.**
- **The economy will continue on a journey of high inflation and low growth for the moment. Capital shortages and crowding out in credit markets may become prevalent. Maturities in debt markets will continue to shorten.**
- **Toward the latter part of the 1980s, a good case for an optimistic scenario can be made. The "taxpayer's revolt" is spreading, favoring efficiency in government. The public now views reducing inflation as the nation's top priority. For the first time, Americans are convinced of an energy crisis. Washington will heed the changing mood of the country toward fiscal conservatism.**

Dr. Sung Won Son
Senior Vice President and
Chief Economist

*The "Nifty Fifties," the "Soaring Sixties" and the "Sour Seventies" are behind us. What will the next decade be like? Will it be the "Euphoric Eighties" or the "Awful Eighties?"*

*Social, economic and political changes over the last quarter century have exceeded the expectations of even the most radical seers. Two states have joined the union. Government spending has increased from $70 billion to over $600 billion. Inflation rates have shot up to double-digit annual rates from less than one percent. The prime and high quality corporate bond rates have jumped from about a three percent range to lofty levels. Prices of oil and gold have shown quantum jumps.*

*There have been other significant structural changes in the economy. The baby-boom generation, which has only heard about the "Great Depression," has gotten accustomed to prosperity and an ever-rising standard of living. A day's pay for a day's work is no longer good enough. The new generation demands job-satisfaction and participation in the decision-making process as well. More recently, they spawned the "Taxpayer's Revolt."*

*American males are now playing a less dominant role in the society. Back in 1954, males accounted for almost 70 percent of the work force; now the share is down to 58 percent. The economy has become more service-oriented than ever before, with about half of all jobs now in service industries as opposed to 38 percent back in 1954.*

## Where Did We Go Wrong?

After a quarter-century of accelerating inflation, "outraged, apprehensive, resigned, frustrated, turned-off, cynical, and bitter" are some of the adjectives that some public opinion analysts have used to describe the mood of America today. In other words, inflation has not only hurt pocketbooks but, even worse, has weakened our social fabric and has eroded confidence in our economic system. Inflation is much more than an economic question, it is a social and political question as well. Not surprisingly, inflation has become the nation's number one concern.

Our first mistake was to allow government spending and deficits to balloon. As shown in Chart 1, Federal spending hovered slightly below 20 percent of GNP from the Korean War until 1965. With deep involvement in the Vietnam War, the share began to climb and by 1975 the Federal Government was spending an amount equivalent to 23.5 percent of GNP.

CHART 1

## FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES AS A PERCENT OF GNP

(seasonally adjusted annual rates)

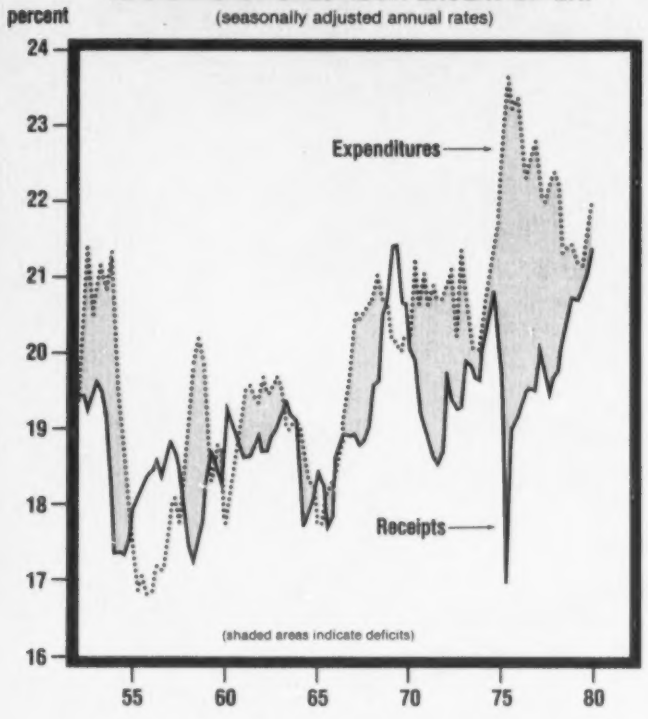



CHART 2

## DEFENSE AND NONDEFENSE EXPENDITURES AS A PERCENT OF GNP

(seasonally adjusted annual rates)

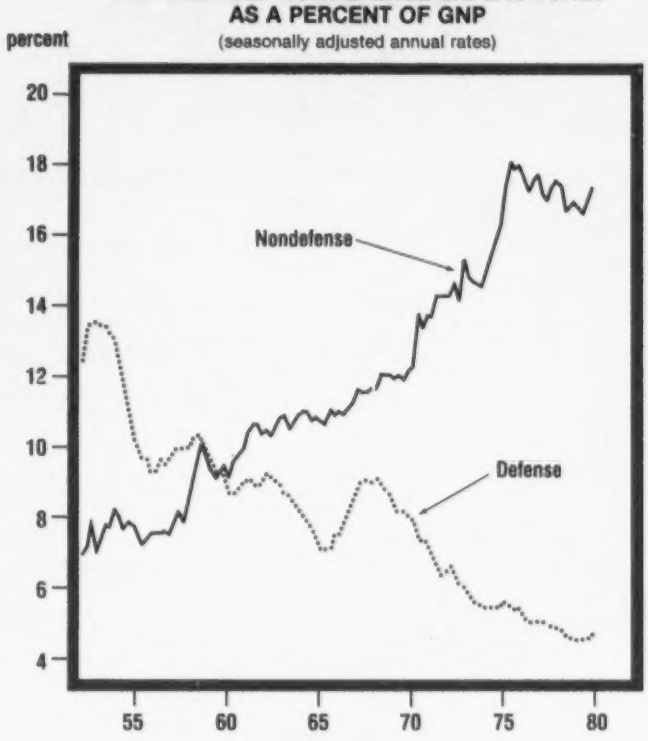



CHART 3

## FEDERAL GRANTS-IN-AID AND THE STATE AND LOCAL GOVERNMENT SURPLUS

(seasonally adjusted annual rates)

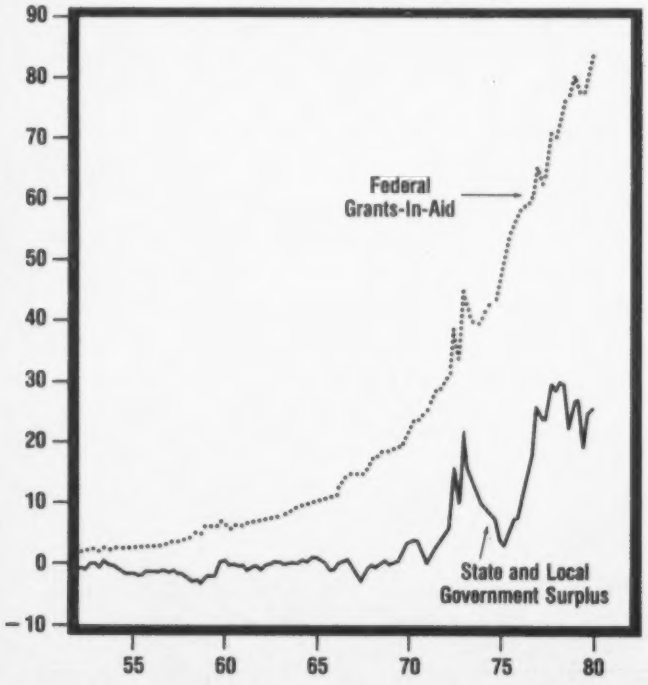
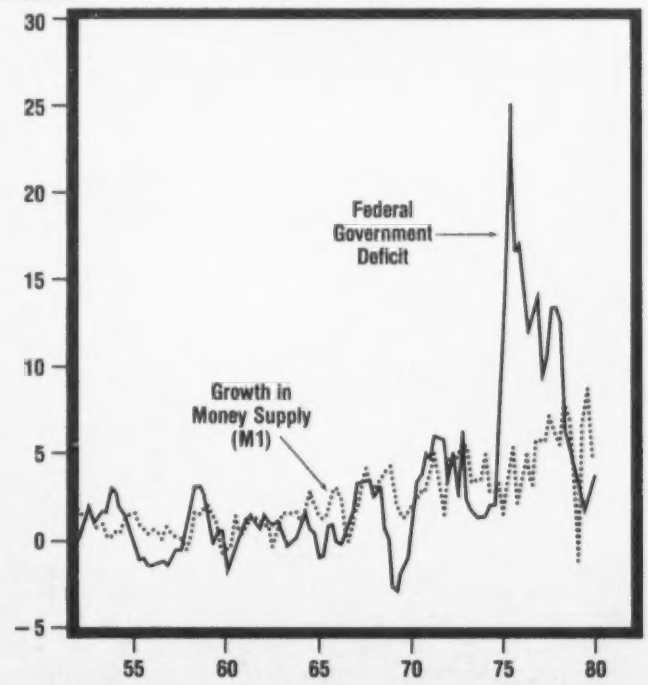



CHART 4

## MONEY SUPPLY GROWTH AND THE FEDERAL DEFICIT

(seasonally adjusted)



Since then the ratio has plateaued at about 22 percent. In the process, the national debt has approached a trillion dollars.

To compound inflation problems, the composition of government spending changed. In the 1950s and early 1960s, while social security, public housing and other programs were important, the Federal Government concentrated mainly on defense-related activities. Technology and industrial development benefited heavily from this.

In the mid-1960s, government spending shifted dramatically toward social programs (Chart 2), which were paid for by printing money and redistributing income. State and local governments were put on the Federal dole by a myriad of grant programs for urban redevelopment, mass transit, water pollution and social service programs (Chart 3). The inflationary spiral was institutionalized by the indexing of social security and other benefits to the consumer price index. Although numerous well-meaning citizens have pointed out the need to kick the liberal spending habit, the fact of the matter is that over 50 percent of the population now depends on spending by governments for a significant part of their income.

In order to support Federal Government largess without crowding out too many other borrowers from the credit markets, the Federal Reserve has financed the deficit (Chart 4). Over-expansion of money and credit led to the ratcheting upward of inflation in the 1970s. Periodic attempts by money managers to restrain the inflationary spiral have meant wide swings in interest rates and business activity.

Our second mistake was to allow government regulations to mushroom. Regulation has become a hydra-headed monster telling us "what to do," "when to do," and "how to do." With excessive government regulations in the face of accelerating Federal spending, business investment has failed to keep pace with the economy's needs. Private productivity growth in the 1970s dropped to half the rate of the 1950s and 1960s.

Our third mistake was the failure to grasp the reality that oil supplies are no longer plentiful and cheap. Americans have gotten used to wasting energy. Ten years ago the U.S. imported only 3.4 million barrels of crude oil per day and paid $3 billion in total for it. Last year we imported about 8 million barrels per day and spent about $60 billion for it.

## Where Next?

There are three alternative paths to consider. The first is to assume that the future will be more of the same. The only tool a planner then needs is a straight ruler to extrapolate the past trend. This approach may seem simplistic, but the probability of "more-of-the-same," at least in the foreseeable future, is reasonably high.

Second, the economy may be near one of those historical turning points. A stagnating economy plagued with double-digit inflation is not the ideal setting for making optimistic statements about the future. Nevertheless, there are sound reasons for believing that better times may be ahead of us. When the world seems to be coming to an end, that might be the time to be cheerful.

Finally, one can assume that the world has changed so much that the past provides absolutely no guide to the future. Anything can happen. There is too much uncertainty to plan for anything. In this case, conservatism, caution and the minimization of risks should be the byword of the day until a clear trend emerges.

How the economy will actually unfold in the future will depend on our willingness to correct the three mistakes discussed earlier. In this regard, the kind of leadership the nation has in the future will be crucial. The upcoming Presidential election may determine the shape of the economy, not only for the next four years, but for the next decade!

## Optimistic Scenario

A year ago we presented a case for an optimistic scenario for the 1980s. The reasons presented in the last April issue of *"Indicators,"* we believe, remain valid.

The opening salvo of economic change was fired in California. Since then, taxpayers in states including Nevada, Idaho, Arizona, Michigan and Texas have moved in similar directions. Some thirty state legislatures have called for constitutional conventions to require balanced budgets. Also, numerous bills have been introduced in Congress to limit government spending and/or taxes. If the movement continues, as seems likely, the nation will have more efficient and downsized governments.

Second, the public, especially the baby-boom generation, now recognizes that the government cannot be everything to everyone and views reducing inflation, not job creation, as top priority. Our legislators and leaders will reflect the mood of the country in setting economic policy toward the goal of reducing inflationary pressure. Incentives for increased business investment will be provided, eventually contributing to productivity gains and economic growth. Government regulation will be reassessed, sharply curtailed and, in some cases, rolled back or abolished.

Third, the gas lines and skyrocketing fuel prices have convinced the electorate that the energy crisis is real. Reflecting the desire of the electorate, Washington will gradually take actions necessary for energy efficiency, conservatism and the development of alternative energy sources. Increased production will combine with slowing consumption to reduce the nation's dependence on foreign oil.

## Pessimistic Scenario

Despite the growing disenchantment with big government and big spending, which have nurtured inflation and starved incentives to save and invest, old habits are hard to kick. Consequently, the economy now embarks on a long-term journey of high inflation and low growth. The 1970s prove to have been "the good, old days." Federal deficits mount and the Federal Reserve speeds up the printing press. Periodic less-than-effective attempts by the Federal Reserve to rein in monetary growth and inflation contribute to further instability in the economy.

**Financial Markets:** A combination of stagflation and the stop-go monetary policy ratchets interest rates upward. With increasing uncertainty and instability, perceived risks in the financial markets increase. Inflation and risk premiums rise. The futility of "saving for a rainy day" is recognized and savings rates are depressed. Investor confidence remains at a low ebb. A growing number of savers bypass financial intermediaries and put existing savings directly into "safe" investments like Treasury bills, gold and silver.

Capital shortages in credit markets become chronic, with lesser quality borrowers shut out either by high interest rates or credit rationing. Young and innovative growth companies do not get a chance to prove themselves. Maturities in debt markets continue to shorten as investors fear further erosion of purchasing power, greater risk of price volatility and default.

# ECONOMIC OUTLOOK
## April 1980

| | Level | | | Percent Change from the Previous Quarter (annual rates) | | | | | | | | Annual Percent Change | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1980E | | | | 1981E | | | | | | |
| | 1979 | 1980E | 1981E | IE | IIE | IIIE | IVE | IE | IIE | IIIE | IVE | 1979 | 1980E | 1981E |
| Consumer Price Index (1967 = 100) | 217.6 | 251.3 | 280.9 | 16.8 | 18.5 | 16.4 | 11.9 | 10.5 | 10.2 | 10.0 | 10.2 | 11.3 | 15.5 | 11.8 |
| Food | 234.9 | 253.7 | 279.1 | 6.5 | 8.0 | 9.0 | 10.0 | 10.8 | 10.6 | 9.5 | 10.0 | 10.9 | 8.0 | 10.0 |
| Nonfood Commodities | 195.0 | 228.5 | 261.0 | 16.5 | 21.6 | 20.0 | 15.5 | 12.8 | 11.9 | 11.7 | 11.5 | 11.7 | 17.2 | 14.2 |
| Services | 234.4 | 273.4 | 301.8 | 19.1 | 20.4 | 16.4 | 9.6 | 8.5 | 8.5 | 8.8 | 9.2 | 11.0 | 16.6 | 10.4 |
| Producer Price Index, Finished Goods (1967 = 100) | 216.0 | 249.2 | 282.6 | 17.6 | 17.7 | 15.1 | 13.9 | 13.1 | 12.3 | 12.3 | 12.1 | 11.0 | 15.4 | 13.4 |
| Compensation Per Manhour Nonfarm Private (1967 = 100) | 247.6 | 271.4 | 301.5 | 9.9 | 10.0 | 10.2 | 10.5 | 11.9 | 11.5 | 11.3 | 11.1 | 9.0 | 9.6 | 11.1 |
| Labor Productivity, Nonfarm Private (1967 = 100) | 115.6 | 113.4 | 112.7 | −1.6 | −3.0 | −3.1 | −1.2 | 0.0 | 0.5 | 0.7 | 1.1 | −1.1 | −1.9 | −0.6 |
| Unit Labor Costs, Nonfarm Private (1967 = 100) | 214.3 | 239.0 | 266.8 | 11.5 | 13.0 | 13.3 | 11.7 | 11.9 | 11.0 | 10.6 | 10.0 | 10.2 | 11.5 | 11.7 |
| Corporate Profits After Taxes, bil. $ | 144.5 | 138.5 | 142.0 | 2.5 | −23.4 | −16.6 | −10.2 | 7.5 | 15.4 | 21.6 | 27.5 | 19.0 | −4.2 | 2.5 |
| Disposable Personal Income, bil. $ (1) | 1624.2 | 1779.5 | 1951.1 | 13.1 | 6.1 | 5.9 | 10.9 | 7.9 | 11.1 | 13.6 | 11.5 | 11.4 | 9.6 | 9.6 |
| Real Disposable Personal Income, bil. $ (2) | 746.4 | 703.3 | 686.6 | −3.7 | −12.4 | −10.5 | −1.0 | −2.6 | 0.9 | 3.6 | 1.3 | 0.1 | −5.9 | −2.2 |
| New Passenger Car Sales (millions of units) | 10.7 | 9.2 | 9.6 | 10.2* | 8.8* | 8.6* | 9.1* | 9.3* | 9.4* | 9.7* | 10.0* | 10.7* | 9.2* | 9.6* |
| New Private Housing Starts (millions of units) | 1.72 | 1.07 | 1.43 | 1.31* | 1.07* | 0.99* | 0.91* | 1.15* | 1.35* | 1.55* | 1.65* | 1.72* | 1.07* | 1.43* |
| Unemployment Rate, % | 5.8 | 6.8 | 7.7 | 6.1* | 6.8* | 7.0* | 7.2* | 7.6* | 7.7* | 7.8* | 7.5* | 5.8* | 6.8* | 7.7* |
| Federal Government Deficit, bil. $ | 11.2 | 24.7 | 3.8 | 17.0* | 11.8* | 34.6* | 35.2* | 8.1* | −2.0* | 4.5* | 4.5* | 11.2* | 24.7* | 3.8* |

E—Estimated.

(1) Take-home pay.

(2) Disposable personal income divided by the CPI.

*All figures are expressed as annual rates, not percent changes.

# ECONOMIC OUTLOOK (Without Inflation)

## April 1980

| | Level (billions of 1972 $) | | | Percent Change from the Previous Quarter (annual rates) | | | | | | | | Annual Percent Change | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1979 | 1980E | 1981E | 1980E IE | 1980E IIE | 1980E IIIE | 1980E IVE | 1981E IE | 1981E IIE | 1981E IIIE | 1981E IVE | 1979 | 1980E | 1981E |
| Gross National Product | 1431.6 | 1419.8 | 1431.6 | 2.6 | −5.0 | −7.4 | −2.6 | 5.4 | 3.7 | 3.5 | 3.0 | 2.3 | −0.8 | 0.8 |
| Consumer Expenditures | 924.5 | 930.0 | 932.5 | 4.8 | −6.5 | −3.5 | −0.6 | 0.5 | 3.8 | 2.4 | 2.2 | 2.6 | 0.6 | 0.3 |
| Durables | 147.1 | 141.6 | 143.6 | 3.1 | −13.4 | −9.8 | −5.0 | 4.6 | 12.5 | 7.6 | 5.2 | 0.3 | −3.7 | 1.4 |
| Nondurables | 349.1 | 348.2 | 346.6 | 2.5 | −11.4 | −3.5 | 2.0 | −1.5 | 3.2 | 0.5 | 1.5 | 1.7 | −0.2 | −0.5 |
| Services | 428.3 | 440.1 | 442.3 | 7.3 | 0.0 | −1.5 | −1.2 | 0.9 | 1.6 | 2.3 | 1.7 | 4.3 | 2.8 | 0.5 |
| Investment | 215.2 | 189.8 | 195.2 | −4.8 | −7.9 | −34.1 | −18.5 | 42.4 | 7.3 | 16.1 | 9.4 | 0.4 | −11.8 | 2.8 |
| Fixed Residential (1) | 56.6 | 48.3 | 47.7 | −22.2 | −23.1 | −20.0 | −10.0 | 2.7 | 15.7 | 10.2 | 10.9 | −5.7 | −14.8 | −1.2 |
| Fixed Nonresidential (2) | 148.8 | 147.0 | 142.0 | 1.0 | −2.0 | −12.6 | −8.8 | −1.2 | 1.0 | 1.2 | 1.2 | 6.2 | −1.2 | −3.4 |
| Structures | 48.1 | 49.2 | 48.0 | −1.0 | −2.1 | −6.5 | −6.5 | −1.5 | 0.3 | 0.7 | 1.5 | 9.6 | 2.1 | −2.4 |
| Producers Durable Equipment | 100.7 | 97.8 | 94.0 | 2.0 | −1.9 | −15.5 | −10.0 | −1.0 | 1.4 | 1.5 | 1.1 | 4.6 | −2.8 | −3.9 |
| Change in Inventories | 9.7 | −5.5 | 5.5 | 1.9* | 1.8* | −10.5* | −15.0* | 1.0* | 2.3* | 8.0* | 10.8* | 9.7* | −5.5* | 5.5* |
| Net Exports (3) | 17.7 | 21.8 | 24.6 | 19.8* | 21.2* | 22.3* | 23.2* | 24.4* | 24.9* | 24.1* | 24.9* | 17.7* | 21.6* | 24.6* |
| Exports | 120.0 | 124.9 | 128.6 | 125.1* | 125.2* | 123.8* | 125.4* | 127.0* | 128.2* | 128.7* | 130.5* | 120.0* | 124.9* | 128.6* |
| Imports | 102.3 | 103.3 | 104.0 | 105.5* | 104.0* | 101.5* | 102.2* | 102.6* | 103.3* | 104.6* | 105.6* | 102.3* | 103.3* | 104.0* |
| Government Purchases | 274.3 | 278.4 | 279.3 | 1.8 | −0.2 | 0.2 | 0.5 | 0.2 | 0.4 | 0.5 | 0.4 | 0.4 | 1.5 | 0.3 |
| Federal | 99.4 | 101.8 | 102.5 | 2.1 | 0.0 | 0.5 | 1.1 | 0.5 | 0.8 | 1.1 | 1.2 | 0.8 | 2.4 | 0.8 |
| State and Local | 174.9 | 176.6 | 176.8 | 1.6 | −0.3 | 0.0 | 0.2 | 0.1 | 0.2 | 0.1 | 0.0 | 0.2 | 1.0 | 0.1 |

E—Estimated

(1) Includes consumer purchases of homes and landlord's purchases of durable goods.

(2) Is roughly equivalent to capital spending.

(3) Exports less imports.

*All figures are dollars, not percent changes.

As stagflation retards sales, income and property tax receipts for state and local governments, tax-exempt bonds pour into credit markets. Credit standings of these governments deteriorate markedly, forcing the Federal Government to come to their rescue.

**Consumers:** Their purchasing power evaporates and consumers resort to debt even to meet necessities. Delinquency rates rise. Discretionary purchases depend on availability of credit and become highly cyclical. In addition, costs of operation and maintenance of automobiles, appliances and houses escalate rapidly. Manufacturers and builders have to be content with replacement demand only. A second income in a family becomes essential for many more households.

**Businesses:** A high inflation and low demand environment mean stiff competition, rising expenses and scant profits. The name of the game becomes "market share." Small and/or weak firms fall by the wayside. Accordingly, market concentration increases in most industries.

Surviving businesses attempt to maintain profits through expense controls and efficiency. Payrolls are held to a minimum and labor-saving devices like automated facilities are widely used. In the face of capital shortages, low demand, high inflation and unprecedented uncertainties, capital spending is generally limited to equipment with fast payback periods.

**Energy:** As an anti-inflation measure, strict price controls on energy are reimposed. Environmental concerns and accidents limit the development of coal and nuclear power. Our dependence on foreign oil increases. In the name of national security, energy rationing is introduced. Businesses and jobs suffer due to limited energy availability.

Government gets deeper into the development of alternative energy sources. As usual, government inefficiency and the bureaucracy become roadblocks to any meaningful progress in the endeavor.

**Foreign Sector:** Oil deficits mount. American-made products gradually lose competitive advantages here at home and abroad. Rising trade imbalances and the ranks of unemployed workers sway the Federal Government to install protectionist trade barriers. Our trading partners retaliate. The value of the dollar becomes volatile and unstable, with the result that the dollar can no longer function as the key reserve currency of the world. The overhang of unwanted dollars overseas further depresses the value of our currency. The Federal Government orders foreign exchange and capital flow controls. There are no winners, only losers.

**Social Problems:** Prices and taxes go up faster than income, shrinking buying power. More and more women in the family seek employment trying to make ends meet, but job opportunities are limited. In the meantime, a growing portion of the labor force ends up on government dole. The working middle income group resents the whole thing. The work ethic and productivity deteriorate.

Under this pessimistic scenario the mood of the nation becomes increasingly angry, cynical and helpless. Divorce rates go up and family units slowly disintegrate. Economic and social trends move in tandem.

## Further Thoughts

These are difficult and frustrating times for the nation. With all the problems facing each of us today, it would be so easy to get depressed and to stop trying to reverse the trend.

However, a careful study of U.S. history tells us that the nation has gone through far worse economic, social and political crises before and has endured. Each time the country has come out in one piece, unscathed and stronger. If over two hundred years of history is any guide at all, history should repeat itself once again.

But, we have to be realistic. Inflation is a long-run problem and, once engrained, this disease is hard to control. It will take a long time because there are no "quick solutions." Like a patient's fever, the economic problems may get worse before getting better. The crucial question is, "Are we ready to bite the bullet?"

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